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September 2, 1994

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Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW -- Room 222
Washington, DC 20554

RE: Price Cap Performance Review for Local Exchange Carriers, CC Docket 94-1

Dear Mr. Caton:

Pursuant to Section 1.1206 of the Commission's Rules, 47 C.F.R. § 1.1206, the Independent Data Communications Manufacturers Association ("IDCMA") hereby files these ex parte comments in the above-captioned proceeding. In these comments, IDCMA responds to the proposal made by the Computer & Communications Industry Association ("CCIA") to grant "relief" from price cap regulations to local exchange carriers ("LECs") that provide free or below-cost inside wiring to schools and public libraries. IDCMA shares CCIA's concern for increasing the access of these and other public institutions to telecommunications services. However, IDCMA believes that CCIA's proposal is inconsistent with the Commission's long-standing pro-competitive policies, would be counter-productive, and would adversely affect other segments of the telecommunications market -- including customer premises equipment ("CPE") and enhanced services. There are, moreover, far more pro-competitive ways in which the goal of increased access to advanced telecommunications services can be achieved.

The CCIA Proposal

In its opening comments in this proceeding, CCIA proposed that "the Commission offer LECs more favorable treatment under the FCC price cap regulation . . . in return for [the LECs] providing advanced inside wiring facilities to the Nation's 2 million

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classrooms, as well as its public libraries."[1] CCIA initially suggested several possible forms "favorable treatment" that a participating LEC might be given, such as an exemption from the obligation to "share" revenues above competitive levels with its ratepayers.[2]

In its reply comments, CCIA backed away from recommending any specific form of preferential treatment. Instead, CCIA proposed that the Commission give LECs "relief . . . from federal price cap regulation in some form that is sufficient to provide a benefit to an LEC commensurate with the benefit it confers through wiring up the public school classrooms and libraries in its service territory."[3] Under the revised CCIA plan, the participating LEC "would propose not only the amount of the benefit that it should receive, but also the form of the benefit."[4]

<u>The Commission Should Not Adopt the CCIA Proposal</u>

IDCMA supports efforts to make advanced telecommunications services available to schools, libraries, and other public institutions. However, it is opposed to the CCIA proposal. The CCIA scheme is a unprecedented and ill-advised departure from the Commission's pro-competitive policies: it would affirmatively authorize LECs to charge supra-competitive prices for local exchange service and use the revenues to cross-subsidize the provision of inside wiring to designated users. The entire endeavor would be insulated from the forces of competition.

<u>The CCIA Proposal is Inconsistent With Commission Policy</u>. The Commission has long recognized the importance of promoting full and fair competition in all segments of the telecommunications market. As the Commission observed in the Notice, "Effective competition in telecommunications investment, facilities, and services has the potential to help meet [user] needs in the most efficient and least costly manner possible, while stimulating domestic economic growth and international competitiveness."[5]

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1 Comment of the Computer & Communications Industry Association on Proposed Rulemaking, CC Docket 94-1 (May 9, 1994) ("CCIA Comments") at 14.

2 <u>Id</u>.

3 Reply Comments of the Computer & Communications Industry Association on Proposed Rulemaking, CC Docket 94-1 (June 29, 1994) at 9 ("CCIA Reply Comments").

4 <u>Id</u>.

5 <u>Price Cap Performance Review for Local Exchange Carriers</u>, Notice of Proposed Rulemaking, 9 FCC Rcd 1687, 1687 (1994) ("NPRM").

The Commission has long sought to provide the benefits of competition to inside wiring customers. Thus, in 1986, the Commission required LECs to unbundle inside wiring from transmission service and offer inside wiring on a detariffed basis. These requirements, the Commission explained at the time, are intended "to increase competition, to promote new entry into the market, to produce cost savings which would benefit the ratepayers, and to create an unregulated competitive marketplace environment for the development of telecommunications."[6] In particular, the Commission noted, the separation of transmission service from inside wiring is intended to "prevent[] cross-subsidization between regulated and nonregulated activities to foster the kind of competitive environment [that is] appropriate for inside wiring services."[7]

The price caps program also is intended to advance the Commission's pro-competitive goals. Although the local exchange is not subject to effective competition (and will not be so for the foreseeable future), the price caps regime attempts to "replicate the marketplace forces of competition" by limiting prices for local exchange service to those that would be expected to prevail in a competitive market.[8] The Commission's price cap rules also seek to ensure that "consumers are protected from cross-subsidization."[9]

Although the goal of providing schools and libraries with access to advanced telecommunications services is an important one, the CCIA proposal would fundamentally undermine the Commission's long-standing and highly effective pro-competitive policies.

- First, the CCIA proposal would jettison the FCC's efforts -- which are at the core of the price cap regime -- to get carriers to set prices for regulated local exchange service at levels that replicate those that would exist in a competitive market. In its place, the CCIA plan would create a system in which an LEC could determine the extent to which it wishes to use its monopoly control of the local exchange bottleneck to set prices above competitive levels.

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6 In the Matter of Detariffing the Installation and Maintenance of Inside Wiring, CC Docket 79-105, Second Report and Order, 59 Rad. Reg. 2d (P&F) 1143, 1143-44 (rel. Feb. 24, 1986).

7 Id. at 1153.

8 NPRM, 9 FCC Rcd at 1688.

9 Id.

- Second, the CCIA proposal would scrap the Commission's efforts to deter LECs from using revenue from regulated service to cross-subsidize nonregulated offerings. In its place, CCIA would substitute a system in which an LEC could choose the extent to which it wishes to use revenues from regulated service to cross-subsidize competitive offerings.

- Third, the CCIA proposal would severely erode the Commission's regulations detariffing LEC-provided inside wiring. If the CCIA plan were to be adopted, the Commission would have to determine the appropriate cost of LEC-provided inside wiring in order to determine the size of the subsidy that the LECs would be allowed to recover by charging supra-competitive prices for transmission service.

- Fourth, the CCIA proposal would impair the Commission's efforts to create a competitive inside wiring market. CCIA openly acknowledges that, under its proposal, the LECs would provide inside wiring to eligible institutions at "bargain" prices[10] that would be below (or at no) cost.[11] Because LECs currently have monopoly power in the local exchange service market, they have the ability to generate supra-competitive profits that would enable them to provide inside wiring at below-cost prices. No other market participant -- even if it is more efficient -- would have the economic ability to match these artificially low prices. As a result, the CCIA proposal would allow the LECs to leverage their local exchange monopoly in order to eliminate competition in an important segment of the inside wiring market.

<u>The CCIA Proposal Would Be Counter-Productive</u>. CCIA contends that its proposal would promote the "wiring up" of America's schools and libraries and their access to a vast array of interactive, multimedia services. In fact, the proposal is likely to impede -- rather than promote -- this result. As the Commission has repeatedly found, the best way to provide users with access to the widest variety of services at the lowest possible cost is through full and fair competition.

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[10] CCIA Comments at 15.

[11] <u>See</u> CCIA Reply Comments at 7 (LECs must be able to charge their local exchange service customers prices that are high enough to recoup their "unrecovered costs" from providing inside wiring to eligible institutions).

The CCIA proposal eliminates the benefits of market forces. Freed from the constraints on local exchange service prices imposed by the price cap regime, and deprived of any effective competition in the inside wiring market, the LEC would loose any incentive to restrain the cost of inside wiring provided to eligible institutions. To the contrary, as under the old rate-of-return regime, the LECs could simply pass along high inside wiring costs to their captive ratepayers. At some point, however, the unchecked cost that the provision of free or below-cost inside wiring imposes on the ratepayers' would undermine their willingness to fund the provision of inside wiring to all eligible institutions. At that point, the LECs are likely to opt for a strategy in which they provide subsidized inside wiring to a small number of eligible users at a high cost to the ratepayers.

The CCIA proposal also would limit user choice. Because the LECs would become the <u>only</u> provider of inside wiring to schools and libraries, they are likely to offer eligible institutions standardized services on a "take-it-or-leave-it" basis, rather than allowing these institutions to select inside wiring services that meet their specific needs.

<u>The CCIA Proposal Would Have an Adverse Effect on the CPE and Enhanced Services Markets</u>. The adverse effect of adopting the CCIA proposal would not be limited to the inside wiring market. Rather, its adverse effects could extend beyond this market.

As an initial matter, adoption of the CCIA proposal would set a dangerous precedent. If the LECs are allowed "relief" from price cap regulation in return for providing below-cost inside wiring to eligible institutions, they can be expected to seek permission to do the same with CPE, enhanced services, and other telecommunications services. The end result would be to allow the LECs to engage in additional Commission-authorized cross-subsidization, further raising prices in the local exchange market while reducing competition in currently competitive markets.

Even if the LECs were not given the express right to cross-subsidize CPE, enhanced services, or other telecommunications services, the CCIA plan would still provide the carriers with an unjustified competitive advantage in these markets. Most public schools and libraries are not likely to be sophisticated purchasers of such services and products. Once they have been given below-cost inside wiring by carriers, they are more likely to purchase other telecommunications services and products from these providers. In part, these institutions may feel "obligated" to purchase these services and products from the carriers in return for the "free" inside wiring. No amount of information about "competitive alternatives" is likely to alter this feeling. Moreover, eligible institutions may be persuaded that it is more efficient to use "one-stop-shopping" and that, once they have received inside wiring from a carrier, it makes sense to buy the other telecommunications services and products from the same carrier. The end result would be a further erosion of competition in the telecommunications market.

There are More Effective Ways to Provide Public Institutions With Access to Advanced Telecommunications Services. Rather than abandoning the Commission's pro-competitive policies, it would be far more effective to use market forces to promote access by schools, libraries, and other public institutions to telecommunications equipment and services. For example, such institutions might be given subsidies -- generated in a competitively neutral manner -- and allowed to choose among competing inside wiring vendors. Alternatively, these institutions might be organized into large "buying groups" that could negotiate collectively with competing vendors. Such possibilities, of course, are beyond the scope of this proceeding. However, the Commission should not foreclose such options by accepting CCIA's invitation to distort the price cap system -- changing a regulatory regime that seeks to replicate market forces into one that promotes the exercise of monopoly power and impairs competition.

Conclusion

For the foregoing reasons, the Commission should reject the CCIA proposal.

As required by the Commission's rules, IDCMA is submitting the original and one copy of this letter. A copy of this letter has also been sent to counsel for CCIA. Please feel free to contact either of the undersigned if you have any questions.

Sincerely,

Herbert E. Marks
Jonathan Jacob Nadler

cc: Chairman Reed E. Hundt
Commissioner James H. Quello
Commissioner Andrew C. Barrett
Commissioner Rachelle B. Chong
Commissioner Susan Ness
Ms. Kathleen M. H. Wallman
Mr. David A. Nall
Mr. Daniel F. Grosh
Ms. Joanne Wall